

Message Text

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PASS EXPORT-IMPORT BANK

E.O. 11652: N/A
TAGS: EFIN, JA
SUBJECT: JAPAN: TRADE FINANCING AND EXCHANGE RISK
MANAGEMENT

REF: STATE 174156

1. SUMMARY: THIS MESSAGE RESPONDS TO EXPORT-IMPORT
BANK'S REQUEST FOR BACKGROUND CONCERNING JAPANESE EXTEN-
SION OF FOREIGN CURRENCY FINANCING, PARTICULARLY OF
LONGER MATURITY, IN SUPPORT OF EXPORTS. OUR MAIN CONCLU-
SIONS ARE:

A) THE BULK OF JAPANESE TRADE IS DOLLAR-DENOMINATED AND
DOLLAR-FINANCED. YEN INVOICING AND FINANCING PROBABLY
ACCOUNT FOR A LITTLE LESS THAN HALF OF JAPAN'S CAPITAL
GOODS EXPORTS, WHICH IN TURN MAKE UP ABOUT 40 PCT OF
TOTAL JAPANESE EXPORTS.

B) THE PRIME MANAGERS OF EXCHANGE RISK ASSOCIATED WITH
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FOREIGN TRADE ARE THE TRADING FIRMS WHOSE INTERNATIONAL
STANDING ALLOWS THEM ALMOST EQUAL ACCESS TO YEN OR DOLLAR
FUNDING AND WHOSE LARGE PREDICTABLE FLOWS OF FOREIGN CUR-
RENCY RECEIPTS AND PAYMENTS GIVE THEM A NATURAL HEDGE
AGAINST FOREIGN EXCHANGE EXPOSURE. (BUT BECAUSE THE TRAD-
ING FIRMS ARE SIMULTANEOUSLY EXPORTERS AND IMPORTERS OF A
BROAD RANGE OF PRODUCTS, IT IS DIFFICULT TO DISENTANGLE

THE INCIDENCE OF EXCHANGE RISK ON A SPECIFIC DEAL FROM THE COMPANIES' OVERALL EXPOSURE POSITION.)

C) INTEREST DIFFERENTIALS, PARTICULARLY ON LONG-TERM FINANCING, ARE CRUCIAL FOR EVALUATING THE BALANCE OF ADVANTAGE BETWEEN ACCEPTING OR AVOIDING EXCHANGE RATE EXPOSURE. FOR EXAMPLE, A 2 1/2 PCT DIFFERENTIAL WOULD ON A TEN-YEAR LOAN COMPENSATE FOR 25-30 PCT PARITY ADJUSTMENT.

D) THE ALLOCATION OF EXCHANGE RISK BETWEEN BUYERS AND SELLERS VARIES WITH THE BUSINESS SITUATION. FOR EXAMPLE, WHEN BUSINESS WAS ROBUST, FOREIGN BUYERS OF JAPANESE SHIPS OFTEN SIGNED LONG-TERM YEN CONTRACTS; IN THE PRESENT MARKET JAPANESE SHIPBUILDERS WOULD PROBABLY NOT CAVIL AT ORDERS PLACED IN ANY REPUTABLE FOREIGN CURRENCY.

E) YEN PRICING IS MORE FREQUENT FOR CAPITAL GOODS EXPORTS THAN FOR OTHER TRANSACTIONS, BUT EVEN IN SUCH DEALS THE INCIDENCE OF EXCHANGE RISK MAY BE OBSCURE BECAUSE CONTRACTS MAY CALL FOR REPAYMENT IN FOREIGN CURRENCY AT NEGOTIATED RATHER THAN MARKET EXCHANGE RATES.

F) NO CLEAR EVIDENCE IS AVAILABLE ON HOW THE RISKS AND RETURNS FROM ABSORBING EXCHANGE RISK ARE ALLOCATED BETWEEN JAPANESE SUPPLIERS AND THE EXPORTING TRADING FIRM. IN LIMITED OFFICIAL USE

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SOME CASES FEES ARE APPARENTLY ASSESSED BY THE TRADING FIRMS; IN OTHER CASES THE RETURN FOR BEARING EXCHANGE RISK IS IMPLICIT IN THE PRICING AND FINANCIAL ARRANGEMENTS BETWEEN THE PARTIES. END SUMMARY.

2. ORGANIZATION OF REPORT. JAPANESE TRADE HAS LONG BEEN, AND CONTINUES TO BE, PREDOMINANTLY DOLLAR-DENOMINATED AND DOLLAR-FINANCED. SECTION ONE PRESENTS SOME EVIDENCE ON THE EXTENT TO WHICH THIS PHENOMENON PREVAILS AND ON THE OTHER FACTORS INFLUENCING JAPANESE TRADERS' WILLINGNESS TO LIVE WITH THE RESULTANT FOREIGN EXCHANGE EXPOSURE OR THEIR ABILITY TO HEDGE SUCH EXPOSURE. THE SECOND SECTION EXAMINES THE IMPACT OF FOREIGN EXCHANGE REGULATIONS ON TRADE FINANCE AND THE ROLE OF GOVT AGENCIES IN PROVIDING TRADE CREDIT AND EXCHANGE RISK INSURANCE. THE THIRD SECTION PRESENTS AN ANALYSIS OF THE TECHNIQUES USED BY JAPANESE FIRMS TO MANAGE THEIR EXCHANGE EXPOSURE. FINANCING OF CAPITAL GOODS EXPORTS IS EXAMINED IN SOME DETAIL BECAUSE OF EXPORT-IMPORT BANK'S SPECIAL INTEREST IN THIS ASPECT.

3. THE MAIN EMPHASIS IN THIS REPORT IS ON MANAGEMENT OF

EXCHANGE RATE RISK BY JAPANESE FIRMS AND MOST OF THE FOCUS IS ON THE EXPOSURE OF EXPORTING FIRMS. HOWEVER, GIVEN THE PROMINENCE OF TRADING FIRMS AS MIDDLEMEN IN IMPORTING AS WELL AS EXPORTING, THE ROLE OF IMPORTS CANNOT BE IGNORED.

4. ATTITUDES TOWARD EXCHANGE RISK AND THE DOLLAR. EXCHANGE RISK MANAGEMENT IS A RELATIVELY NEW PROBLEM FOR JAPANESE BUSINESSMEN. FOR TWO DECADES, UP UNTIL AUG 71, THE YEN WAS PEGGED AT 360 YEN TO THE DOLLAR; THE YEN HAD LITTLE INTERNATIONAL STANDING; AND JAPANESE TRADE WAS ALMOST EXCLUSIVELY DENOMINATED AND FINANCED IN DOLLARS WITHOUT UNDUE CONCERN BY TRADERS ABOUT EXCHANGE RISK.

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5. THE REVALUATION FOLLOWING THE NEW ECONOMIC POLICY OF THE U.S. IN AUG 71 AND THE SUBSEQUENT FLOATING OF THE YEN DISRUPTED THIS PATTERN, BUT EXPORTERS' CONCERN ABOUT EXCHANGE RISK MANAGEMENT -- OR AT LEAST ABOUT EXCHANGE RATE RISK ON DOLLAR CLAIMS -- SEEMS TO HAVE DISSIPATED RAPIDLY AFTER THE OIL EMBARGO AND OIL PRICE INCREASES IN THE FALL AND WINTER OF 1973-74 AND THE ENSUING DETERIORATION IN JAPAN'S BALANCE OF PAYMENTS. WITH THE JAPANESE CURRENT ACCOUNT IN LARGE (\$4.7 BIL) DEFICIT IN 1974 AND SMALL (\$0.7 BIL) DEFICIT IN 1975, AND RAPID INFLATION (24 PCT IN 1974 AND 12 PCT IN 1975), IT WAS THE WEAKNESS OF THE YEN AND NOT THE DOLLAR WHICH WAS THE DOMINANT CONCERN.

6. THUS IT HAS BEEN JUST THE PAST COUPLE OF YEARS THAT THE MANAGEMENT OF EXCHANGE RISK HAS AGAIN BECOME AT ALL URGENT IN THE MINDS OF MANY JAPANESE EXPORTERS. SOME EVIDENCE OF HEIGHTENED SENSITIVITY TO THE PROBLEM CAN BE DETECTED IN EARLIER PATTERNS OF CAPITAL EXPORT PRICING, BUT EVEN NOW, FOR REASONS DISCUSSED BELOW, THIS SEEMS TO BE OF LESS GENERAL CONCERN THAN MIGHT BE EXPECTED.

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7. THE PERHAPS UNIQUE ROLE OF THE DOLLAR IN JAPANESE EXTERNAL TRANSACTIONS AND THE ROLE OF THE TRADING FIRMS ALSO SERVE TO PROVIDE WIDE OPPORTUNITIES FOR INTERNAL HEDGING OF EXCHANGE RISKS ASSOCIATED WITH DOLLAR EXPORT FINANCING. THIS WILL BE TREATED IN SOMEWHAT MORE DETAIL LATER, BUT THE BROAD FACTS ARE THAT ABOUT 80 PCT OF JAPANESE EXPORTS AND ALMOST ALL JAPANESE IMPORTS ARE DOLLAR-DENOMINATED (ACCORDING TO THE MINISTRY OF FINANCE). THE TOP 13 TRADING COMPANIES HANDLE AN ESTIMATED 60 PCT OF JAPAN'S TRADE--BOTH IMPORTS AND EXPORTS -- SO THESE FIRMS TEND TO BE ABLE TO LOOK AHEAD TO A CONTINUING PATTERN OF DOLLAR PAYMENTS TO SERVE AS A HEDGE AGAINST FUTURE DETERIORATION IN THE VALUE OF THEIR DOLLAR RECEIPTS.

8. EQUALLY COMPREHENSIVE STATISTICS ARE NOT AVAILABLE ON THE FINANCING PATTERNS FOR JAPAN'S TRADE, BUT IT IS CLEAR THAT HERE ALSO THERE IS A GREAT DEAL OF DOLLAR FINANCING, PARTLY OF COURSE BECAUSE THERE ARE CERTAIN ADVANTAGES IN FINANCING IN THE CURRENCY IN WHICH TRADE IS DENOMINATED. A VERY SUBSTANTIAL PROPORTION OF IMPORT FINANCING IS BELIEVED TO BE FINANCED IN DOLLARS AND MUCH OF JAPAN'S OTHER EXTERNAL FINANCING IS DOLLAR-DENOMINATED. FOR EXAMPLE, BANKERS HAVE TOLD US THAT THE NEW YORK DOLLAR ACCEPTANCE MARKET IS DOMINATED BY JAPANESE TRADE BILLS. IMPACT LOANS, WHICH ARE DOLLAR-DENOMINATED LOANS TO JAPANESE INDUSTRY WHICH THEY MAY USE FOR GENERAL CORPORATE PURPOSES ALONE HAVE IN RECENT YEARS RISEN \$1 1/2 TO 2 BIL ANNUALLY. ANNUALLY, JAPANESE BOND ISSUES ABROAD, WHICH HAVE BEEN LARGELY DOLLAR-DENOMINATED, AVERAGE ANOTHER \$1 TO 1.5 BIL. OVERALL, THE LIABILITIES TO FOREIGNERS OF THE JAPANESE PRIVATE SECTOR TOTALED OVER \$50 BIL AT THE END OF LAST YEAR, AND STILL EXCEEDED BY OVER \$5 BIL PRIVATE CLAIMS ON

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FOREIGNERS. IF DIRECT INVESTMENT IS EXCLUDED, AS BEING OF LIMITED VALUE IN MANAGING FOREIGN EXCHANGE RISK, THE EX-

CESS OF LIABILITIES OVER CLAIMS IS ABOUT \$15 BIL. NO DATA ARE AVAILABLE ON THE CURRENCY DENOMINATION OF THESE CLAIMS AND LIABILITIES, BUT WE WOULD BE SURPRISED IF A VERY HIGH PROPORTION WERE NOT DOLLAR-DENOMINATED. THERE IS LITTLE DOUBT, IN ANY CASE, THAT THERE ARE SUBSTANTIAL VOLUMES OF FOREIGN CURRENCY BORROWING, MAINLY DOLLARS, WHICH AFFORD A BASIS FOR INTERNAL HEDGING.

9. CURRENT RELATIVE INTEREST RATE LEVELS IN JAPAN AND FOR DOLLAR FINANCING ABROAD ALSO OPERATE TO MAKE THE PROVISION OF DOLLAR FINANCING ATTRACTIVE TO JAPANESE BUSINESSMEN. LONGER-TERM MONIES IN JAPAN CAN NOW BE OBTAINED AT ABOUT 6 1/2-7 PCT FOR PRIME BORROWERS. WITH LONG-TERM DOLLAR LOANS NOW IN THE 9 PCT RANGE, THERE IS A SUBSTANTIAL INTEREST PREMIUM ON LENDING DOLLARS WHICH MAY BE BALANCED AGAINST PERCEIVED FOREIGN EXCHANGE RISK. A ROUGH CALCULATION SUGGESTS THAT A 2 1/2 PCT PER ANNUM INTEREST PREMIUM SHOULD MAKE LENDERS AND BORROWERS APPROXIMATELY INDIFFERENT TO THE RISK OF A 25-30 PCT PARITY CHANGE ON A TEN-YEAR LOAN. THE PREMIUM IS BOUND AT SOME POINT TO BE A FACTOR IN CONSIDERING A FINANCING PACKAGE, OR AT LEAST TO HAVE SOME WEIGHT IN THE DECISION ON THE ENTIRE EXPORT/FINANCING DEAL. TIRE EXPORT/

10. ATTITUDES TOWARD FOREIGN EXCHANGE RISK MANAGEMENT ARE ALSO AFFECTED BY TAX TREATMENT OF FOREIGN EXCHANGE LOSSES AND GAINS AND JAPANESE TAXATION APPEARS TO PROVIDE CONSIDERABLE FLEXIBILITY. CURRENT TAX AND ACCOUNTING GUIDELINES IN JAPAN GIVE A COMPANY HOLDING LONG-TERM CLAIMS AND DEBTS DENOMINATED IN FOREIGN CURRENCIES TWO CHOICES IN THE CASE OF LARGE EXCHANGE RATE FLUCTUATIONS. THEY MAY CHOOSE

EITHER TO RE-APPRAISE THEIR ASSETS AND LIABILITIES AT THE LIMITED OFFICIAL USE

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RATE EFFECTIVE AT THE END OF A REPORTING PERIOD OR TO LEAVE THEM AT THE INITIAL BOOK VALUE UNTIL THE DATE OF MATURITY OF PAYMENTS. THEREFORE, A COMPANY MAY WRITE OFF OR NOT WRITE OFF, AS IT WISHES, UNREALIZED EXCHANGE LOSSES. SMALL AND MEDIUM-SIZED EXPORTERS ARE ALSO GIVEN ADDITIONAL RELIEF UNDER NEW LEGISLATION THIS FISCAL YEAR. QUALIFYING EXPORTERS MAY CARRY BACK EXCHANGE RATE LOSSES THREE YEARS RATHER THAN THE NORMAL ONE YEAR. FROM 1972-77, UNDER A NOW EXPIRED PROGRAM, THE GOVT ALSO PERMITTED THE ESTABLISHMENT OF TAX-FREE RESERVES AGAINST LOSSES FROM FOREIGN EXCHANGE RATE FLUCTUATIONS.

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C O R R E C T E D C O P Y TEXT (PARA 11.)

11. THUS IT APPEARS THAT JAPANESE TRADING PRACTICES,
FINANCING PATTERNS, AND TAX AND ACCOUNTING TREATMENT ALLOW
JAPANESE FIRMS TO FACE FOREIGN EXCHANGE EXPOSURE WITH A
FAIR AMOUNT OF EQUANIMITY EVEN IF THE RISKS ON INDIVIDUAL
TRANSACTIONS VIEWED IN ISOLATION APPEAR LARGE.

12. NEVERTHELESS, ATTITUDES TOWARD EXCHANGE RATE RISK,
DOLLAR FINANCING, ETC., ARE CHANGING IN JAPAN. AS A MATTER
OF POLICY, THE JAPANESE AUTHORITIES ARE PROMOTING GRADUALLY
INCREASED USE OF THE YEN IN INTERNATIONAL TRANSACTIONS.
THE YEN SHIFT, FOR EXAMPLE, ENCOURAGES GREATER USE OF THE
YEN IN FOREIGN TRADE TRANSACTIONS. UNDER THE CLOAK OF
INTERNATIONALIZATION OF THE YEN, LENDING ABROAD BY JAPAN
IN THE FORM OF FOREIGN BOND ISSUES HAS BEEN SUBSTANTIALLY
INCREASED. THE VERY LARGE EXCHANGE RATE CHANGES OF THE
PAST 1 1/2 YEARS CANNOT BUT HAVE MADE JAPANESE TRADERS
AND FINANCIERS ACUTELY AWARE OF THE NEED FOR MORE CAREFUL
EXCHANGE RISK MANAGEMENT.

13. BUT CHANGE HAS BEEN SLOW. THE PATTERNS AND PRACTICES
OF A GENERATION ARE NOT CHANGED OVERNIGHT. IF PROOF WERE
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NEEDED, IT MIGHT BE FOUND IN REPORTS SUCH AS THE ONE THAT

KOMATSU, A MAJOR JAPANESE HEAVY EQUIPMENT PRODUCER, LAST YEAR SUFFERED EXCHANGE LOSSES OF YEN 10 BIL. THERE IS ALSO RESISTANCE FROM CUSTOMERS AND BORROWERS ACCUSTOMED TO DOING BUSINESS WITH THE JAPANESE IN FOREIGN CURRENCY-DENOMINATED INSTRUMENTS. THERE IS A LINGERING BELIEF THAT FOR THE LONG HAUL THE U.S. DOLLAR AND THE U.S. ECONOMY REMAIN THE STRONGEST IN THE WORLD. COUPLED WITH THE JAPANESE' TENDENCY TO UNDERESTIMATE THE STRENGTH OF THEIR ECONOMY (IN PARTICULAR THEY NEVER FORGET THEIR DEPENDENCE ON OIL AND OTHER RAW MATERIAL IMPORTS), THESE FACTORS MAKE IT LIKELY THAT THE JAPANESE WILL FOR SOME TIME YET CONTINUE TO VIEW THE DOLLAR AS THE WORLD'S MAJOR INTERNATIONAL CURRENCY AND USE IT ACCORDINGLY.

14. EXCHANGE CONTROLS AND EXCHANGE RISK. MOST JAPANESE EXPORT FINANCING IS SHORT-TERM, IN PART BECAUSE JAPANESE EXCHANGE REGULATIONS REQUIRE PROMPT SETTLEMENT. THE STANDARD METHOD OF SETTLEMENT (SMS) REQUIRES THAT SETTLEMENT FOR MOST EXPORTS BE WITHIN SIX MONTHS AFTER SHIPMENT OR UP TO ONE YEAR PRIOR TO SHIPMENT. EXCEPT FOR SHIP EXPORTS, PREPAYMENT IS NOT COMMON IN JAPAN. EXCEPTIONS TO THE SMS REQUIREMENT PERMITTING A LONGER SETTLEMENT PERIOD ARE MADE PRINCIPALLY FOR EXPORTS OF CAPITAL GOODS. TRADE FIGURES SHOW THAT IN FY 77 ONLY \$6.7 BIL OF EXPORTS (OUT OF TOTAL EXPORTS OF \$85 BIL) WERE SETTLED MORE THAN A YEAR AFTER SHIPMENT.

15. EXPORT CREDITS CARRIED OUT IN ACCORDANCE WITH THE SMS ARE GENERALLY FINANCED WITH SHORT-TERM MONEY INSTRUMENTS AND SUCH CREDITS ARE DOMINANTLY PROVIDED BY PRIVATE FINANCIAL INSTITUTIONS. PROMPT DISCOUNTING OF FOREIGN CURRENCY EXPORT BILLS ALLOWS THE EXPORTING FIRM TO LIMITED OFFICIAL USE

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MINIMIZE HIS FOREIGN CURRENCY EXPOSURE. HOWEVER, THE EXPORTER WILL STILL FACE EXCHANGE RISK BETWEEN THE TIME OF CONTRACTING AND THE TIME AN EXPORT BILL IS DRAWN AND DISCOUNTED.

16. OFFICIAL CREDITS AND LONGER-TERM EXPOSURE. EXPORT FINANCING FOR CAPITAL GOODS, USUALLY LONG-TERM FINANCING, TAKES QUITE A DIFFERENT FORM THAN THE SHORT-TERM FINANCING. A SUBSTANTIAL PORTION OF SUCH LONG-TERM FINANCING IS HANDLED BY GOVT-AFFILIATED FINANCIAL INSTITUTIONS.

17. AMONG GOVT-AFFILIATED FINANCIAL AGENCIES, JAPAN EXIMBANK PLAYS THE DOMINANT ROLE. IN JFY 77 JAPAN EXIMBANK COMMITTED CREDITS FOR EXPORT FINANCING AMOUNTING TO ABOUT \$2.5 BIL. THESE CREDITS FOR PLANT EXPORTERS WERE \$2.1 BIL, WITH THE BALANCE USED FOR SHIP EXPORT FINANCING.

OUR ROUGH ESTIMATE IS THAT LAST FISCAL YEAR ABOUT 40 PCT OF THE PLANT EXPORTS WERE FINANCED BY JAPAN EXIMBANK. (NOTE: EXIM DATA IS ON A COMMITMENT BASIS, AND CAPITAL EQUIPMENT DATA ARE ON A CUSTOMS BASIS, SO CONSIDERABLE INTERPOLATION IS NECESSARY TO ARRIVE AT ROUGH ESTIMATES OF PROPORTIONS.)

18. EXIM RATES RANGE BETWEEN 6 AND 9 PCT. NORMAL MATURITY OF LOANS IS FIVE YEARS BUT CAN RUN UP TO 15 YEARS. IN PRINCIPLE, EXPORT FINANCING BY APAN EXIMBANK TAKES THE FORM OF JOINT FINANCING. JAPAN EXIM FINANCES UP TO 80 PCT OF THE TOTAL EXPORT RECEIPTS OF THE PROJECT, COMMERCIAL BANKS THE BALANCE. IN SOME EXCEPTIONAL CASES, EXIMBANK IS AUTHORIZED TO FINANCE 100 PCT OF THE PROJECT. EXIM CREDITS ARE ONLY AVAILABLE FOR MERCHANDISE EXPORTS, SUCH AS MACHINERY OR EQUIPMENT; SERVICES CANNOT BE FINANCED THRU EXIMBANK FACILITY.

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19. EXIMBANK CREDITS ARE PREDOMINANTLY YEN CREDITS, AND OUR UNDERSTANDING IS THAT ALL EXPORT CREDITS ARE IN YEN. THE BANK'S ANNUAL REPORT INDICATES EXIMBANK MADE LOAN COMMITMENTS DENOMINATED IN FOREIGN CURRENCY ONLY SLIGHTLY MORE THAN \$0.1 BIL IN FY 77, OUT OF THE BANK'S TOTAL ANNUAL LOAN COMMITMENT OF ABOUT \$3.0 BIL DURING THE LAST FISCAL YEAR. WE HAVE BEEN UNABLE TO PIN DOWN THE PRECISE SOURCE OR USE OF THIS FOREIGN CURRENCY LENDING, BUT IT WAS PRESUMABLY ASSOCIATED EITHER WITH THE IMPORT FINANCING (PERHAPS THE EMERGENCY IMPORT FINANCING PROGRAM) OR WITH DIRECT INVESTMENT FINANCING.

20. THE OVERSEAS ECONOMIC COOPERATION FUND IS ALSO AN IMPORTANT GOVT-AFFILIATED FINANCIAL INSTITUTION PROVIDING LONG-TERM TRADE CREDITS. THE FUND WAS ESTABLISHED TO PROVIDE FINANCIAL ASSISTANCE FOR DEVELOPMENT AND STABILIZATION PROJECTS IN SOUTHEAST ASIA AND OTHER DEVELOPING REGIONS WHICH WOULD BE DIFFICULT FOR JAPAN EXIMBANK AND/OR COMMERCIAL BANKS TO FINANCE. THE FUND EXTENDS LOANS EITHER TO FOREIGN GOVERNMENTS OR JAPANESE COMPANIES TO FINANCE DEVELOPMENT PROJECTS OR IMPORTS OF PRODUCTS NECESSARY FOR STABILIZATION. THE AMOUNT OF TOTAL LOAN COMMIT-LIMITED OFFICIAL USE

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MENTS IN FY 76 WAS ABOUT \$0.8 BIL, OF WHICH ABOUT 10 PCT WERE EXTENDED TO JAPANESE COMPANIES.

21. THE AVERAGE LOAN RATE OF THE FUND WAS REPORTED AT 3.2 PCT PER ANNUM IN FY 76. THE AVERAGE REPAYMENT PERIOD FOR THE FUND WAS ABOUT 26.5 YEARS INCLUDING AN AVERAGE GRACE PERIOD OF EIGHT YEARS. BY PROJECT, THE MAJOR PORTION OF THE FUND CREDITS GO TO MINING AND MANUFACTURING AND TELECOMMUNICATION AND TRANSPORTATION PROJECTS BUT ELECTRIC POWER PROJECTS ARE ALSO IMPORTANT, ACCOUNTING FOR ROUGHLY 14 PCT OF THE FUND'S LOAN COMMITMENTS IN 1976.

22. THE FUND PROVIDES YEN CREDITS PRIMARILY BUT DID PROVIDE FOREIGN CURRENCY LAONS TO JAPANESE COMPANIES FROM FY 72 THRU FY 74.

23. EXIMBANK AND OECF CREDITS PROVIDE FINANCING AMOUNTING TO NEARLY ONE-HALF OF JAPAN'S PLANT EXPORTS. OTHER GOVT-AFFILIATED FINANCIAL INSTITUTIONS PROVIDING LONG-TERM TRADE CREDITS INCLUDE THE SMALL BUSINESS FINANCE CORP AND THE SMALL BUSINESS CREDIT INSURANCE CORP, WHICH DEAL PRIMARILY WITH SMALL AND MEDIUM-SIZED PLANT EXPORTERS. THEIR IMPACT ON THE OVERALL PICTURE OF JAPAN'S PLANT EXPORT FINANCING, HOWEVER, SEEMS MINOR.

24. SINCE LATE 1974 A MITI-ADMINISTERED EXCHANGE RISK GUARANTEE FACILITY HAS BEEN AVAILABLE FROM THE JAPANESE GOVT. HOWEVER, THE FACILITY IS REPORTED TO BE SOMEWHAT UNPOPULAR WITH EXPORTERS, WHO BELIEVE ITS PREMIUMS ARE RELATIVELY HIGH. MITI DATA INDICATE THAT, AT LEAST THRU THE END OF 1977, THE PROGRAM WAS LITTLE USED.

- FY 74 FY 75 FY 76 FY 77
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NO. OF CASES INSURED 2 6 5 4

AMOUNT INSURED (IN YEN
MIL) 925 9,011 5,501 1,514

SOURCE: MITI, TRADE WHITE PAPER

25. UNDER THE PROGRAM, EXPORTERS CAN INSURE AGAINST FOREIGN EXCHANGE LOSSES OF 3 PCT OR MORE INCURRED IN THE SECOND THRU FIFTEENTH YEARS AFTER THE SIGNING OF A CONTRACT. CURRENCIES COVERED BY THE INSURANCE INCLUDE THE POUND STERLING, THE FRENCH FRANC, SWISS FRANC, DEUTSCHE-MARK, AND U.S. DOLLAR. THE INSURANCE IS APPLICABLE TO CONTRACTS FOR THE EXPORT OF AIRCRAFT, SHIPS, RAILROAD EQUIPMENT, AND CERTAIN OTHER INDUSTRIAL PLANT AND EQUIPMENT. PARTICIPANTS, IN ADDITION TO THE BASIC PREMIUMS, ARE REQUIRED TO MAKE CONTRIBUTIONS TO THE PROGRAM IN CASE OF EXCHANGE GAINS OF 3 PCT OR MORE. PARTICIPANTS HAVE A CHOICE OF BLANKET COVERAGE OR SEPARATE INSURANCE FOR INDIVIDUAL PROJECTS. THE PREMIUM FOR BLANKET COVERAGE IS CURRENTLY 0.8 PCT ANNUALLY AND 1.5 PCT ANNUALLY FOR SEPARATE COVERAGE.

26. TECHNIQUES FOR MANAGING FOREIGN EXCHANGE RISK. THE METHODS OF MANAGING FOREIGN EXCHANGE RISK IN JAPAN VARY WIDELY AMONG FIRMS AND ACCORDING TO THE TYPE OF TRANSACTION UNDERTAKEN. EVEN RELATIVELY SIMPLE PURCHASES OR SALES UNDER SHORT-TERM CONTRACTS, WHERE THE DEGREE OF RISK CAN BE FAIRLY EASILY IDENTIFIED, GIVE RISE TO A VARIETY OF POSSIBILITIES FOR HEDGING OR ACCEPTING EXCHANGE RISK. LONGER-TERM CONTRACTS TYPICALLY INVOLVE MORE UNCERTAINTY AND FEWER OPPORTUNITIES FOR BOTH PARTIES TO A TRANSACTION TO HEDGE THEIR EXPOSURE DIRECTLY, WITH THE RESULT THAT PROVISIONS FOR EXCHANGE RATE CONTINGENCIES ARE FREQUENTLY LIMITED OFFICIAL USE

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WRITTEN INTO CONTRACTS AND FIRMS OFTEN RESORT TO INDIRECT FINANCIAL ADJUSTMENTS TO LIMIT THEIR EXPOSURE. EVEN WHERE NO EXPLICIT CONTRACTS ARE INVOLVED, COMPANIES MAY FACE REAL ECONOMIC EXPOSURE TO EXCHANGE RISK SIMPLY DUE TO THEIR SPECIALIZATION IN PRODUCTION FOR THE OVERSEAS MARKET OR THEIR RELIANCE ON OVERSEAS SUPPLIES. UNAVOIDLY, A VARIETY OF CURRENT AND CAPITAL TRANSACTIONS ARE CAUGHT UP

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IN THE ATTEMPT OF JAPANESE FIRMS TO MANAGE THEIR EXCHANGE
RISK.

27. FORWARD EXCHANGE CONTRACTS, THE TEXTBOOK ILLUSTRATION
OF HOW TO COVER AN EXPOSED FOREIGN CURRENCY POSITION, ARE
READILY AVAILABLE TO JAPANESE TRADERS TO COVER NORMAL
COMMERCIAL TRANSACTIONS OF SHORT-TERM MATURITIES. YEN/DOL
FORWARD CONTRACTS ARE ACTIVELY TRADED IN MATURITIES OF ONE,
TWO, THREE, SIX, NINE AND TWELVE MONTHS. REFLECTING THE
DOMINANCE OF DOLLAR TRANSACTIONS IN JAPAN'S TRADE, DOLLAR/
YEN CONTRACTS MAKE UP THE BULK OF ALL FORWARD EXCHANGE
TRANSACTIONS IN THE TOKYO INTERBANK MARKET. THE FORWARD
MARKET APPEARS TO BE HIGHLY EFFICIENT AND THE PREMIUM OR
DISCOUNT ON FORWARD YEN CONTRACTS GENERALLY CLOSELY
APPROXIMATES THE INTEREST DIFFERENTIAL BETWEEN DOLLAR AND
YEN SECURITIES OF COMPARABLE MATURITIES. THUS, THE
FORWARD MARKETS PROVIDE A FAIRLY OBJECTIVE INDEX OF THE
PRESENT YEN VALUE OF DELAYED RECEIPTS OF FOREIGN CURRENCY
OR THE IMPLICIT RETURN (THE INTEREST DIFFERENTIAL)
INVOLVED IN ACCEPTING EXCHANGE RISK AND LEAVING A FOREIGN
CURRENCY EXPOSURE UNCOVERED.

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28. ALTHOUGH THE FORWARD MARKET PROVIDES OBJECTIVE
CRITERIA FOR MEASURING THE COST/RETURNS FOR HEDGING OR

ACCEPTING EXCHANGE RISK, BY MOST ACCOUNTS THE FORWARD CONTRACTS ARE OF SECONDARY IMPORTANCE TO JAPANESE FIRMS IN MANAGING THEIR FOREIGN CURRENCY EXPOSURE. TRANSACTION COSTS TEND TO BE RELATIVELY HIGH AND FOREIGN EXCHANGE CONTROLS ARE TO SOME EXTENT INHIBITING. MOST IMPORTANTLY, ONLY NET, NOT GROSS, EXPOSURE NEED BE COVERED IF THE RISK IS TO BE HEDGED; AND OTHER TRANSACTIONS MAY SERVE THE SAME OBJECTIVE AT LOWER COST.

29. AS NOTED ABOVE, THE JAPANESE TRADING COMPANIES ACT AS MIDDLEMEN FOR THE PREPONDERANCE OF JAPANESE TRADE, AND THE BULK OF TRADE, BOTH EXPORTS AND IMPORTS, IS DENOMINATED IN DOLLARS. THE RESULT IS THAT THE TRADING FIRMS ARE IN A NATURAL POSITION TO GENERATE A REGULAR AND PREDICTABLE FLOW OF RECEIPTS AND PAYMENTS FROM ABROAD IN THEIR ROLE AS BOTH EXPORTERS AND IMPORTERS. TO THE EXTENT THEY ARE AVERSE TO EXCHANGE RISK, THEY ARE IN A POSITION TO MATCH INTERNALLY THE PROFILE OF RECEIPTS AND PAYMENTS IN FOREIGN CURRENCY AND THUS HEDGE THEMSELVES, OR, DEPENDING ON THE PERCEIVED GAINS AND THEIR WILLINGNESS TO ACCEPT EXCHANGE RISK, TO LEAVE THEIR POSITIONS UNBALANCED. IN THIS RESPECT, THE TRADING COMPANIES' POSITION IS ANALOGOUS TO THAT OF A BANK. TO A MORE LIMITED EXTENT, THE TRADING COMPANIES ARE ALSO IN A SIMILAR POSITION WITH RESPECT TO LONGER MATURITY CONTRACTS. IN RECENT YEARS, THE COMPANIES HAVE EXPANDED THEIR OVERSEAS CAPITAL POSITIONS, PARTICULARLY IN THE U.S., AND, ACCORDING TO ONE SOURCE, THE DOLLAR-DENOMINATED ASSETS OF THE MAJOR COMPANIES ARE APPROXIMATELY AS LARGE AS THEIR YEN ASSETS. AS A RESULT, THESE FIRMS CAN FINANCE THEMSELVES IN EITHER YEN OR DOLLARS ON AN EQUAL FOOTING. ONE ESTIMATE IS THAT OUTSTANDING CREDIT BY LIMITED OFFICIAL USE

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TRADING COMPANIES NOW AMOUNTS TO YEN 5 TRILLION, THAT GUARANTEES ADD ANOTHER YEN 3 TRILLION, AND CREDITS BY THEIR FOREIGN SUBSIDIARIES ADD ANOTHER YEN 2 TRILLION. THE INVOLVEMENT OF TRADING FIRMS IN LONG-TERM CAPITAL EXPORTS IS INDICATED BY A RECENT JAPAN EXTERNAL TRADE ORGANIZATION STUDY SHOWING THAT IN THE CASE OF 71 RECENT SUCCESSFUL PLANT EXPORT BIDS ONLY SEVEN DID NOT INVOLVE A MAJOR TRADING FIRM.

30. THE ADVANTAGE OF DIVERSIFIED RECEIPTS AND PAYMENTS IS NOT SO READILY AVAILABLE TO THE SPECIALIZED PRODUCER/EXPORTER. TRADING FIRMS ARE IN A POSITION TO COMMAND A PREMIUM FOR ACCEPTING THE EXCHANGE RISK OF EXPORTING AND IMPORTING. WE HAVE BEEN TOLD THAT IN SOME CASES AN EXPLICIT CHARGE IS MADE FOR THIS SERVICE. MORE GENERALLY, THOUGH, IT IS LIKELY THE COST IS IMPLICIT IN THE PRICING AND FINANCIAL ARRANGEMENTS BETWEEN THE SUPPLIER AND THE

TRADING FIRM. THE PRECISE CHARGE WILL PRESUMABLY DEPEND ON THE BALANCE OF COMMERCIAL ADVANTAGE BETWEEN THE FIRMS BUT IS PROBABLY LIMITED BY THE ALTERNATIVE AVAILABLE TO THE PRODUCER OF COVERING HIS FOREIGN EXCHANGE EXPOSURE BY A DIRECT PURCHASE OR SALE OF FORWARD EXCHANGE.

31. AUTO EXPORTS AND PETROLEUM IMPORTS APPEAR TO BE THE TWO MOST PROMINENT EXCEPTIONS TO THE RULE THAT MOST JAPANESE TRADE IS FUNNELED THROUGH TRADING FIRMS. IT IS OUR UNDERSTANDING THAT THE MAJOR AUTO EXPORTERS, NISSAN AND TOYOTA, HANDLE THEIR OWN EXPORT ARRANGEMENTS AND THAT OIL IMPORTS ARE CONDUCTED PRIMARILY BY THE LARGE OIL COMPANIES.

32. DENOMINATING AND FINANCING FOREIGN TRADE IN YEN PROVIDES AN ALTERNATIVE APPROACH TO FOREIGN EXCHANGE RISK MANAGEMENT. (OF COURSE, YEN PRICING DOES NOT ELIMINATE EXCHANGE RISK, IT SIMPLY SHIFTS IT TO THE FOREIGN PARTNER.) FOR A VARIETY OF REASONS, FOR THE BULK OF JAPANESE TRADE, LIMITED OFFICIAL USE

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YEN PRICING HAS NOT BEEN WIDELY USED IN THE PAST AND EVEN NOW IS GENERALLY CONFINED TO A PORTION OF CAPITAL EXPORTS. THE TRADITIONAL DOMINANCE OF THE DOLLAR AS AN INTERNATIONAL CURRENCY IS PROBABLY REASON ENOUGH TO EXPLAIN THE LIMITED USE OF YEN PRICING. WHERE YEN PRICING IS USED, IT APPEARS TO REFLECT STRONG ECONOMIC ADVANTAGES OF

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JAPANESE FIRMS. THE OUTSTANDING EXAMPLE OF YEN PRICING WAS SHIPBUILDING. BEGINNING AROUND 1970, AS JAPANESE PRODUCTION BEGAN TO SET THE WORLD STANDARD, JAPANESE SHIPBUILDERS WERE ABLE TO INSIST ON, AND GET, CONTRACTS DENOMINATED IN YEN. THEY WOULD DOUBTLESS BE LESS INSISTENT NOW.

33. EVEN WHERE YEN PRICING IS USED, CARE SHOULD BE TAKEN IN EVALUATING THE EXTENT OF EXCHANGE RISK EXPOSURE INVOLVED. IT IS OUR UNDERSTANDING THAT SUCH CONTRACTS MAY FREQUENTLY CONTAIN REPAYMENT PROVISIONS IN FOREIGN CURRENCY AT A NEGOTIATED, RATHER THAN A MARKET, RATE OF EXCHANGE. CONTRACTS MAY ALSO CONTAIN ESCALATOR CLAUSES TRIGGERED BY EXCHANGE RATE CHANGES OR CONTRACT PROVISIONS THAT PRICES BE RENEGOTIATED IF EXCHANGE RATES MOVE PAST SOME THRESHHOLD. A RECENT JETRO PUBLICATION SUGGESTS THE FOLLOWING LANGUAGE BE WITTEN INTO FOREIGN TRADE CONTRACTS: "IF SELLER'S COSTS OF PERFORMANCE ARE INCREASED AFTER HE DATE OF THIS CONTACT BY REASON OF INCREASED FREIGHT RATES, TAXES OR OTHER GOVERNMENTAL CHARGES, AND INSURANCE RATES INCLUDING WAR RISK, OR IF ANY VARIATION IN RATES OF EXCHANGE INCREASE SELLER'S COSTS OR REDUCES

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SELLER'S RETURN, BUYER AGREES TO COMPENSATE SELLER FOR SUCH INCREASED COST OR LOSS OF INCOME."

34. APPRAISAL OF THE MANAGEMENT OF EXCHANGE RISK IN THE CASE OF CAPITAL EQUIPMENT EXPORTS IS HANDICAPPED BY THE LACK OF SYSTEMATIC, COMPREHENSIVE STUDIES OF THE SUBJECT. IN THIS SECTION WE HAVE ATTEMPTED TO GET A BETTER FIX ON THE EXTENT TO WHICH JAPANESE CAPITAL EQUIPMENT EXPORTS ARE DENOMINATED AND FINANCED IN YEN OR FOREIGN CURRENCY BY DRAWING ON CUSTOMS TRADE DATA, MITI PLANT EXPORT DATA, JAPAN EXIM DATA, AND EVIDENCE FROM FOREIGN EXCHANGE REGULATION DATA. OUR CONCLUSION IS THAT MORE THAN HALF OF JAPANESE CAPITAL EQUIPMENT EXPORTS IS FOREIGN CURRENCY-DENOMINATED AND FOREIGN CURRENCY-FINANCED. USE OF YEN-DENOMINATED AND YEN-SETTLED CONTRACTS IS MOST COMMON IN SHIP EXPORTS AND PLANT EXPORTS, PROBABLY IN PART REFLECTING THE HEAVY INVOLVEMENT OF OFFICIAL CREDITS IN THESE SECTORS IN THE FORM OF YEN SUPPLIERS' CREDITS. SEPARATE DATA ON DEFERRED PAYMENTS INDICATES THAT FOR AT LEAST 80 PCT OF CAPITAL EQUIPMENT EXPORTS, SUPPLIERS RECEIVE PAYMENT WITHIN ONE YEAR. SINCE SETTLEMENT CAN BE MADE EITHER BY CASH PAYMENT OR BY DRAWING ON BUYERS' CREDITS, AND

SINCE WE WOULD EXPECT A FAIRLY LARGE PROPORTION OF CREDIT DEALS IN CAPITAL EXPORTS, WE ARE LED TO THE CONCLUSION THAT (A) BUYERS' CREDITS PROBABLY ACCOUNT FOR A SIGNIFICANT PORTION OF CAPITAL EXPORT FINANCING, AND (B) FINANCIAL INTERMEDIARIES (BANKS OR TRADING FIRMS) PROVIDE THE CREDITS, THEREBY SHIFTING ANY EXCHANGE EXPOSURE AWAY FROM THE SUPPLYING FIRMS. SEPARATE FINANCIAL DATA INDICATE THAT A LARGE AMOUNT OF THE FINANCING OF SUCH BUYERS' CREDITS IS FUNDED ABROAD, PRESUMABLY LARGELY IN DOLLARS.

35. MOF HAS ESTIMATED THAT 20 PCT OF ALL JAPANESE EXPORTS LIMITED OFFICIAL USE

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WAS YEN-DENOMINATED. ACCORDING TO MOF CUSTOMS BASIS TRADE DATA, CAPITAL EQUIPMENT EXPORTS CONSTITUTED 40, 41 AND 43 PCT OF TOTAL EXPORTS IN 1975, 76 AND 77 RESPECTIVELY. THUS IF YEN DENOMINATION WERE USED EXCLUSIVELY IN CAPITAL EQUIPMENT EXPORTS, NO MORE THAN 50 PCT OF CAPITAL EQUIPMENT EXPORTS COULD BE YEN-DENOMINATED. IN PRACTICE THE PERCENTAGE IS PROBABLY A LITTLE LESS THAN 50 PCT. YEN PRICING IS MOST FREQUENTLY CITED IN THE CASE OF SHIPBUILDING AND PLANT EXPORTS. AND THESE TWO SECTORS PROBABLY ENCOMPASS MOST OF THE YEN PRICING.

36. MOST CASE STUDIES OF CAPITAL EQUIPMENT EXPORT FINANCING IN JAPAN THAT WE ARE FAMILIAR WITH DEAL ONLY WITH PLANT EXPORTS, DRAWING ON MITI DATA. THE MITI DEFINITION OF PLANT EXPORTS INCLUDES PROJECTS WITH A VALUE PER CONTRACT OF \$500,000 OR MORE INCLUDING CONSTRUCTION COSTS AND INTEREST EXPENSES. SINCE THE REPORTED FIGURES INCLUDE INTEREST RECEIPTS OVER THE LIFE OF THE CONTRACT AS WELL AS OFFSHORE OUTLAYS, THE MITI DATA OVERSTATE BY A CONSIDERABLE AMOUNT THE CAPITAL EQUIPMENT EXPORTS RECORDED IN THE CUSTOMS TRADE DATA. ALSO THE MITI DATA ARE ON A CONTRACT BASIS WHICH, GIVEN THE LONG LEAD TIMES INVOLVED AND THE RECENT RAPID EXPANSION OF CONTRACTS, TENDS TO BLUR THE RELATION BETWEEN PLANT EXPORT FIGURES AND CUSTOMS TRADE DATA. JAPANESE ANALYSTS GENERALLY ESTIMATE THAT MITI PLANT EXPORT DATA TRANSLATE INTO CAPITAL EQUIPMENT EXPORTS HALF AS LARGE; INTEREST AND OFFSHORE EXPENDITURES REDUCE THE FIGURES BY 30 PCT AND TIMING DISCREPANCIES RESULT IN A FURTHER 20 PCT REDUCTION. THUS IT APPEARS THAT JAPANESE EXPORTS UNDER THE RUBRIC PLANT EXPORTS HAVE ACCOUNTED FOR BETWEEN 10-14 PCT OF JAPANESE CAPITAL EQUIPMENT EXPORTS.

- CAPITAL EQUIPMENT EXPORTS AND RELATED DATA
- (\$ MIL, FISCAL YEARS)

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1973 1974 1975 1976 1977

TOTAL EXPORTS
CUSTOMS BASIS 39,679 58,390 56,982 70,577 84,644

TOTAL CAPITAL
GOODS EXPORTS
(CUSTOMS
BASIS) 14,583 20,628 22,533 28,832 36,034

RATIO:
CAPITAL/
TOTAL
EXPORTS .37 .35 .40 .41 .43

MITI PLANT
EXPORTS 2,918 3,858 5,241 8,006 8,607

PLANT EXPORTS
ADJUSTED TO
CUSTOMS
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BASIS 1,460 1,930 2,620 4,000 4,300

RATIO:PLANT/
CAPITAL EXPORTS
(CUSTOMS
BASIS) .10 .09 .12 .14 .12

VESSEL EXPORTS
(CUSTOMS BAS.) 3,982 5,962 6,140 7,670 8,180

RATIO:VESSELS;
CAPITAL EXPORTS
(CUSTOMS BAS.) .27 .29 .27 .27 .23

DEFERRED PAYMENTS
CONTRACTS
(CUSTOMS BASIS) 2,394 2,766 2,766 4,391 6,650
RATIO:DEFERRED
PAYMENTS/CAPITAL
EXPORTS .16 .13 .12 .15 .18

37. ACCORDING TO MITI DATA, PLANT EXPORT CONTRACTS IN 1976 WERE 74 PCT YEN-DENOMINATED, 20 PCT DOLLAR-DENOMINATED AND 6 PCT OTHER FOREIGN CURRENCY-DENOMINATED. IT WOULD APPEAR FROM THESE DATA THAT, IN THE CASE OF PLANT EXPORTS (AS MEASURED BY MITI) MOST OF THE EQUIPMENT EXPORTED FROM JAPAN IS PROBABLY DENOMINATED IN YEN WITH FOREIGN CURRENCY FINANCING USED TO COVER THE OFFSHORE COMPONENT. IT SHOULD BE EMPHASIZED THAT PLANT EXPORTS ACCOUNT FOR ONLY ABOUT 14 PCT OF JAPANESE CAPITAL GOODS EXPORTS. SHIP EXPORTS ARE THE OTHER MAJOR EXPORT BELIEVED TO BE YEN-DENOMINATED AND THEY HAVE GENERALLY ACCOUNTED FOR A LITTLE MORE THAN ONE-QUARTER OF TOTAL CAPITAL EQUIPMENT. THUS SHIP AND LIMITED OFFICIAL USE

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PLANT EXPORTS FAIRLY WELL EXHAUST THE POSSIBILITIES FOR YEN-DENOMINATED CAPITAL EXPORTS, LEAVING ABOUT 60 PCT OF JAPAN'S CAPITAL EXPORTS THAT ARE FOREIGN CURRENCY-DENOMINATED AND PRESUMABLY FOREIGN CURRENCY-FINANCED.

38. THE WIDE USAGE OF YEN PRICING IN PLANT EXPORTS PROBABLY REFLECTS, IN PART, THE HEAVY INVOLVEMENT OF OFFICIAL CREDITS IN THEIR FINANCING. OUR ROUGH ESTIMATE IS THAT ROUGHLY 40 PCT OF PLANT EXPORTS IN 1977 WAS FINANCED BY JAPAN EXIMBANK. INCLUDING OECF AND OTHER PUBLIC FINANCING, OFFICIAL CREDITS PROBABLY FINANCED ABOUT 50 PCT OF JAPANESE PLANT EXPORTS. THESE CREDITS ARE ALMOST EXCLUSIVELY PROVIDED IN YEN AND PRIMARILY IN THE FORM OF SUPPLIERS' CREDITS. ALTHOUGH THE INVOLVEMENT OF SUPPLIERS' CREDITS DOES NOT REQUIRE THAT THE EXPORTED GOODS BE INVOICED IN YEN, FROM THE MITI DATA THIS DOES APPEAR TO BE THE PRACTICE.

39. ON THE BASIS OF INDIRECT EVIDENCE, IT APPEARS THAT THE FINANCING OF PLANT EXPORTS ACCOUNTS FOR MOST OF THE USE OF SUPPLIERS' CREDITS. UNDER THE STANDARD METHOD OF SETTLEMENT, EXPORTS MUST BE SETTLED WITHIN SIX MONTHS. EXCEPTIONS REQUIRE MITI APPROVAL. TRADE DATA SHOW THAT EXPORTS SHIPPED UNDER CONTRACTS CALLING FOR DEFERRED PAYMENT OF OVER ONE YEAR HAVE AMOUNTED TO NO MORE THAN 18 PCT OF THE TOTAL VALUE OF CAPITAL EQUIPMENT EXPORTS.

40. NOTE THAT NO PROBLEM OF EXCEPTION TO THE STANDARD METHOD OF SETTLEMENT WOULD BE INVOLVED WHERE BUYERS' CREDIT IS INVOLVED. THE EXPORTER WOULD RECEIVE PROMPT SETTLEMENT EVEN IF THE EQUIPMENT WERE FINANCED OVER AN EXTENDED PERIOD. SINCE PLANT EXPORTS, WHICH ARE KNOWN TO INVOLVE A HIGH PERCENTAGE OF YEN SUPPLIERS' CREDIT, HAVE

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GENERALLY RUN TO TWO-THIRDS OR MORE OF THE SIZE OF DEFERRED PAYMENTS SHIPMENTS, IT WOULD APPEAR THAT A SUBSTANTIAL PORTION OF THE CASES WHERE PAYMENT IS DEFERRED MORE THAN ONE YEAR ARE PROBABLY ACCOUNTED FOR BY SHIPMENTS INVOICED AND FINANCED IN YEN. HOWEVER, A BILLION DOLLARS A YEAR OF FOREIGN CURRENCY SUPPLIERS' CREDITS COULD EASILY FIT IN THE AVAILABLE DATA.

41. WE ARE STRUCK BY THE RELATIVELY SMALL AMOUNT OF TRADE LISTED AS BEING UNDER DEFERRED PAYMENT BASIS. SINCE CREDIT DEALS ARE PREVALENT IN CAPITAL GOODS EXPORTS, WE MUST CONCLUDE THAT A LARGE AMOUNT OF JAPAN'S CAPITAL

EQUIPMENT EXPORTS IS FINANCED BY SOME FORM OF BUYER'S CREDIT. IT SEEMS LIKELY THAT MOST OF THIS CREDIT IS LARGELY FOREIGN CURRENCY (DOLLAR) CREDIT. OUR IMPRESSION IS THAT OVERSEAS BANK YEN LENDING IS TOO SMALL TO BE A SIGNIFICANT FACTOR IN CAPITAL EQUIPMENT EXPORT FINANCING AND THAT FOREIGN YEN BOND ISSUES HAVE NOT BEEN CLOSELY TIED TO PURCHASES IN JAPAN AND IN ANY CASE HAVE BEEN TOO RECENT A PHENOMENON TO ACCOUNT FOR THE ESTABLISHED PATTERN OF EXPORT FINANCING. FIGURES PRESENTED EARLIER THAT MORE THAN HALF OF JAPAN'S CAPITAL EQUIPMENT EXPORTS LIMITED OFFICIAL USE

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ARE FOREIGN CURRENCY-DENOMINATED ALSO SUPPORT THE VIEW THAT MUCH OF THIS IS DOLLAR FINANCING.

47. THIS IS ALSO CONSISTENT WITH THE VIEW THAT THE PROMINENCE OF TRADING COMPANIES IN SUCH CAPITAL EXPORT DEALS IS IN PART DUE TO THEIR ACCESS TO FOREIGN CURRENCY CREDIT AND THEIR ABILITY TO ABSORB THE FOREIGN EXCHANGE RISK FROM THE SUPPLIER AND HEDGE IT FOR THEMSELVES. EXACTLY HOW THE RESULTANT EXCHANGE RISK IS SHARED BETWEEN THE SUPPLIER AND THE TRADING FIRM WILL VARY FROM CASE TO CASE. AS INDICATED EARLIER, WE HAVE BEEN TOLD THAT IN SOME CASES AN EXPLICIT FEE IS ASSESSED THE SUPPLIER. HOWEVER, THE RANGE OF OTHER POSSIBILITIES IS WIDE AND ARRANGEMENTS IN ANY CASE PROBABLY SHIFT WITH THE FLUX OF COMMERCIAL ADVANTAGE.

48. AS NOTED EARLIER, THE TRADING FIRMS GENERALLY HAVE FAIRLY WIDE LATITUDE BETWEEN FUNDING SUCH DEALS IN YEN OR DOLLARS AND A BALANCING OF INTEREST DIFFERENTIALS AGAINST PROSPECTIVE EXCHANGE RATE CHANGES WILL WEIGH HEAVILY IN THE CHOICE OF CURRENCY AND WHETHER OR NOT ATTEMPTS ARE MADE TO HEDGE EXPOSED POSITIONS. AS IN ANY SUCH DEAL, A VARIETY OF INTEREST TERMS (E.G. FIXED OR FLOATING) CAN BE CONSTRUCTED AND FEW CLEAR GENERALIZATIONS ABOUT TERMS CAN BE MADE. THERE MAY BE A BIAS TOWARD LONGER MATURITIES IN DOLLAR CONTRACTS SINCE LONGER-TERM FINANCING IS GENERALLY AVAILABLE IN DOLLARS RATHER THAN IN YEN.

49. WHILE LARGE TRADING FIRMS, THROUGH THEIR FOREIGN SUBSIDIARIES, HAVE GOOD ACCESS TO DOLLAR CREDITS, ORDINARY DOMESTIC JAPANESE FIRMS HAVE, AT LEAST UNTIL RECENTLY, BEEN MORE CIRCUMSCRIBED IN THEIR ABILITY TO MATCH FOREIGN CURRENCY LIABILITIES AGAINST CLAIMS IN ORDER LIMITED OFFICIAL USE

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TO HEDGE LONGER-TERM EXPOSURE. AS NOTED ABOVE, IMPACT LOANS AND FOREIGN CURRENCY BOND ISSUES HAVE THE EFFECT OF OFFSETTING EXPOSURE ON FOREIGN CURRENCY CLAIMS. HOWEVER, ACCESS TO SUCH FOREIGN CURRENCY CREDITS IS CONTROLLED BY THE MOF AND BANK OF JAPAN AND UNTIL RECENTLY THEY DISCOURAGED SUCH BORROWING WHERE THE PURPOSE WAS SOLELY TO HEDGE FOREIGN CURRENCY EXPOSURE. HOWEVER, IN APRIL IT WAS REPORTED THAT MOF HAD DECIDED TO PERMIT IMPACT LOANS FOR HEDGING PURPOSES WITH EXPORTERS OF AUTOS, SHIPS AND PLANS EXPECTED TO BE THE MAJOR USER.

50. EVEN IF HIGHER INTEREST RATES IN PROSPECTIVELY WEAKER CURRENCIES PROVIDE AN OFFSET TO POSSIBLE CURRENCY DEPRECIATION, TRADERS CAN HAVE WIDELY DIFFERENT PERCEPTIONS OF WHAT THE LIKELY COURSE OF EVENTS WILL BE OVER AN EXTENDED HORIZON AND THUS WHICH CURRENCY IS MORE ATTRACTIVE TO FINANCE LONG-TERM DEALS OR WHETHER OR NOT IT IS PRUDENT TO TRY TO NEUTRALIZE LONG-TERM EXPOSURE. THIS PROPOSITION IS NEATLY ILLUSTRATED BY RECENT INTERNATIONAL CAPITAL MOVEMENTS IN AND OUT OF JAPAN. ALTHOUGH THE YEN IS CURRENTLY STRONG AND INTEREST RATES ARE AT OR CLOSE TO POSTWAR LOWS, A NUMBER OF JAPANESE FIRMS HAVE BEEN BORROWING LONG TERM IN DM AT LOW INTEREST RATES WHILE OTHER FIRMS HAVE BEEN SHIFTING FROM DOLLAR BORROWING TO YEN BORROWING. AT THE SAME TIME, THE QUEUE OF FOREIGN BORROWERS OF YEN IN JAPAN HAS BEEN GENERALLY LENGTHENING WHILE SIMULTANEOUSLY PURCHASES OF JAPANESE SECURITIES BY FOREIGNERS HAS BEEN EPISODICALLY STRONG. IT SEEMS CLEAR THAT MARKET PARTICIPANTS HOLD A WIDE RANGE OF VIEWS ABOUT THE RISKS AND RETURNS FROM FOREIGN CURRENCY EXPOSURE.

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